In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 252

ESTATE OF LILLIAN VIRGINIA SPERLING, DECEASED, WARREN RICHARD SPERLING, ADMINISTRATOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Eugene Sperling (taxpayer) was in the business of buying, selling, processing, and refining precious metals. He and his wife, Lillian Sperling (both of whom are now deceased), filed joint income tax returns for the years 1953 and 1954. The Commissioner has asserted a deficiency against Lillian Sperling's administrator with regard to the income from her husband's precious metals business which was reported on their joint income tax returns (R. 102a–103a).[1]

[1] "R." references are to petitioner's appendix filed in the court of appeals.

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On both his books and income tax returns taxpayer recorded purchases and sales of metals on the cash receipts and disbursement basis even though he maintained inventories of precious metals (R. 117a, Pet. 42). In determining the deficiency here in question, the Commissioner did not disturb the cash method of accounting employed by the taxpayer (Pet. 42).

During the taxable years 1953 and 1954 involved in the instant case, a shortage of precious metals had created a black market. In order to avoid documenting their activities, many of the people from whom taxpayer bought metals insisted on being paid in cash. Most of taxpayer's checks were thus made out to cash and indicated neither the recipient nor the purpose. In some instances taxpayer's books indicated the name of the person from whom he was buying but in most the only notation was "cash." The Commissioner allowed taxpayer a deduction for cost of goods sold whenever a check payable to cash could be matched to a bill for metal purchased on approximately the same date for the same amount. Petitioner claims that taxpayer is entitled to additional deductions for two bills (neither of which is marked paid) which could not be matched with any single check but which approximate the amount of certain combinations of checks. The lower courts concluded that "The proceeds of these checks may have been used to purchase metals or for personal expenses" and that there is no proof that the cash was used "for purchases" (Pet. 39–40, R. 114a–116a).

Petitioner introduced into evidence the business records of Kastenhuber & Lehrfeld (K & L), a re-

finer of precious metals with whom taxpayer had traded during the taxable years. Petitioner urged that insofar as these records showed more purchases by taxpayer from K & L than were recorded on taxpayer's own books, he was entitled to an additional cost of goods sold deduction. Both lower courts noted that the difference between K & L's and taxpayer's records could be attributed to the fact that the K & L records were kept on the accrual method while taxpayer's books were maintained on the cash receipts method. The Tax Court concluded that it would be artificial to put the taxpayer on the accrual method as to this one supplier. Moreover, both courts below concluded that acceptance of petitioner's argument would decrease taxpayer's income in one year but substantially increase it in another and that such a result would hardly be what petitioner sought (Pet. 40–42, 116a–118a).

After the Tax Court issued its opinion petitioner filed a motion for reconsideration contending that before the Commissioner could assess any deficiency he must recompute taxpayer's entire income on the accrual basis (R. 123a–136a). The Tax Court denied the motion, and petitioner renewed this argument on appeal (R. 138a; Pet. 42). The court of appeals noted that petitioner had not claimed that the deficiency would be reduced if the accrual method was employed. Rather, petitioner was simply arguing that the Commissioner's hands were tied unless taxpayer's income could be recomputed on the accrual basis. The court held that the Commissioner would be within his discretion in deciding not to question an improper

accounting method used by the taxpayer in keeping his books and filing his returns because the possible additional revenue might not be worth the considerable effort that would be required. Moreover, the court of appeals observed that petitioner cannot successfully oppose the Commissioner's determination simply by pointing out that the Commissioner has worked within the framework of the taxpayer's own improper accounting system, and that, so long as the deficiencies are not themselves infected by the system's shortcomings, petitioner may not avoid them simply by pointing to the inadequacy of taxpayer's own accounting system (Pet. 42–45).

Whenever a taxpayer maintains an inventory of goods, the accrual method of accounting provides the clearest picture of his taxable income from purchases and sales. Thus, whenever possible, he must utilize this method of accounting in filing his returns (Treas. Regs. § 1.446–1(c)(2)(i)). In the present case, however, the taxpayer maintained his books and consistently filed his income tax returns on the cash method, *i.e.*, he reported a sale as having been made when he received the cash and took a deduction for metals purchased when he paid for them. Taxpayer has no records from which the Commissioner can determine when sales were made (as opposed to when taxpayer received the cash) or when metals were purchased (as opposed to when he paid for them).

The Regulations explicitly provide that "the Commissioner may authorize a taxpayer to continue the use of a method of accounting consistently used by the taxpayer, even though not specifically authorized

by the regulations, * * * if, in the opinion of the Commissioner, income is clearly reflected by the use of such method * * *" (Treas. Regs. 1.446-1(c)(2)(ii)), or, in the alternative, the Commissioner may substitute his own system of accounting if in his opinion the substituted system more clearly reflects income (Section 446(b), Internal Revenue Code of 1954). This Court has held that the Commissioner has broad discretion in passing on the method employed by taxpayers in computing income and that the courts will not overturn his decision unless the evidence clearly shows abuse of discretion. *Commissioner* v. *Hansen*, 360 U.S. 446, 467; *Lucas* v. *American Code Co.*, 280 U.S. 445, 449.

Taxpayer's books show only the amount of cash paid or received and the time of the payment or receipt; they thus do not disclose sufficient information to enable the Commissioner to recompute his income on the accrual basis (R. 47a, 114a, 117a; Pet. 42–43). Moreover, taxpayer's suppliers and customers (other than K & L) no longer have their records pertaining to transactions with the taxpayer (R. 47a, 66a–67a). In other cases where a taxpayer's books were inadequate to enable the Commissioner to put the taxpayer on the accrual basis, other courts of appeals have concluded that the Commissioner is justified in utilizing the cash receipts method, despite the fact that the taxpayer's income would have been more clearly reflected by the accrual method had the necessary information been available. *In re Newman*, 94 F. 2d 108 (C.A. 6); *Greengard* v. *Commissioner*,

29 F. 2d 502 (C.A. 7). The Commissioner was thus entitled to conclude that, while taxpayer's method of accounting was improper, it would nevertheless (in light of the lack of records) give the best available picture of taxpayer's income for the years 1953 and 1954.[2]

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted.

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[2] Moreover, even where an exhaustive examination of a taxpayer's cash basis records would enable the Commissioner to reconstruct taxpayer's income on the accrual method, the burden is not on the Commissioner to perform this work. Rather, where a taxpayer claims his own erroneous method of accounting as a defense to an asserted deficiency, the burden is on the taxpayer to reconstruct his income on the new method of accounting which he claims would more clearly portray his income. Cf. *Goodrich* v. *Commissioner*, 243 F. 2d 686, 690–691 (C.A. 8); *Schram* v. *United States*, 118 F. 2d 541, 543–544 (C.A. 6). Petitioner in the instant case made no effort to redetermine his income on the accrual basis (Pet. 43, R. 117a).

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